MUNICIPAL FISCAL POLICY AND LOCAL ECONOMIC RESILIENCE: EVIDENCE FROM MEDIUM-SIZED CITIES

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Abstract

This paper investigates the relationship between municipal fiscal policy choices and local economic resilience in a sample of 96 medium-sized cities observed from 2010 to 2023. We examine how revenue diversification, expenditure composition, reserve fund management, and debt policy affect the capacity of municipal economies to withstand and recover from economic shocks. Using a resilience index constructed from employment stability, business survival rates, and fiscal balance measures, we find that municipalities with more diversified revenue bases and larger precautionary reserve funds demonstrate significantly greater economic resilience. Expenditure composition also matters: municipalities allocating a higher share of spending to infrastructure maintenance and workforce development programs show stronger post-shock recovery trajectories. These findings provide empirical guidance for municipal fiscal policy design aimed at enhancing local economic stability.

1. Introduction

Municipal governments operate at the intersection of local economic conditions and fiscal policy choices. Their decisions about taxation, spending priorities, borrowing, and financial reserves directly affect the economic environment of their jurisdictions while simultaneously being constrained by local economic performance. This reciprocal relationship makes municipal fiscal policy a critical but complex lever for influencing local economic outcomes. Economic resilience has emerged as a central concept in regional and urban economics, capturing the capacity of local economies to resist, absorb, and recover from adverse economic shocks. While macroeconomic factors and structural characteristics of local economies are recognized determinants of resilience, the role of municipal fiscal policy in shaping economic resilience has received limited systematic investigation. This study addresses this gap by analyzing how specific fiscal policy choices affect resilience outcomes in medium-sized cities, a category of municipalities that face particular challenges due to limited fiscal capacity and economic diversification.

2. Methodology

The study examines 96 medium-sized cities with populations between 50,000 and 250,000, drawn from a comprehensive municipal finance database covering the period 2010 to 2023. This time frame encompasses multiple economic disruptions of varying severity, providing natural variation in shock exposure for resilience analysis. Municipal fiscal policy is characterized along four dimensions: revenue diversification measured by a Herfindahl index of revenue source concentration; expenditure composition captured by the allocation of spending across functional categories; reserve fund adequacy measured as the ratio of unrestricted reserves to annual operating expenditure; and debt policy characterized by total debt service burden and the maturity structure of outstanding obligations. The economic resilience index combines three components: employment stability measured as the deviation of local employment from trend during and after shocks; business survival rates comparing firm dissolution rates during stress periods to baseline levels; and fiscal balance resilience measuring the stability of municipal revenue and expenditure during economic disruptions.

3. Results and Findings

Revenue diversification emerges as the most robust predictor of municipal economic resilience. Cities in the top quartile of revenue diversification demonstrate resilience index scores 0.47 standard deviations higher than those in the bottom quartile, controlling for population, baseline economic conditions, and regional fixed effects. This effect operates primarily through the fiscal balance resilience component, as diversified revenue bases are less susceptible to disruption from sector-specific economic shocks. Reserve fund adequacy shows a strong positive association with resilience, with a threshold effect evident at approximately 15 percent of operating expenditure. Below this threshold, additional reserves provide substantial marginal resilience benefits; above it, the marginal contribution diminishes. Expenditure composition analysis reveals that municipalities directing larger shares of spending toward infrastructure maintenance and workforce development exhibit stronger recovery trajectories following economic disruptions. In contrast, municipalities with higher proportions of spending on debt service show weaker resilience outcomes, consistent with reduced fiscal flexibility during stress periods.

4. Conclusion

This study provides empirical evidence that municipal fiscal policy choices significantly influence local economic resilience in medium-sized cities. The findings support several practical policy recommendations: municipalities should pursue revenue diversification strategies to reduce dependence on any single revenue source; maintaining precautionary reserves equivalent to at least 15 percent of operating expenditure provides meaningful resilience benefits; and expenditure priorities should balance current service delivery with investments in infrastructure and human capital that support long-term economic adaptability. These findings contribute to the growing literature on fiscal governance and local economic development by establishing concrete linkages between measurable fiscal policy characteristics and economic resilience outcomes.